IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A.D. 1976

No. 76-1082

Docketed February 4, 1977

IN THE MATTER OF:

MEREDOSIA HARBOR & FLEETING SERVICE, INC., and RIVER ROAD MARINE REPAIR, INC.

FARMERS & TRADERS STATE BANK OF MEREDOSIA,

Petitioner,

v.

ROBERT M. MAGILL,

Respondent.

SUPPLEMENT TO

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS
SOUTHERN DIVISION

IN THE MATTER OF:

MEREDOSIA HARBOR & FLEETING SERVICE, INC., being a consolidated case of:

MEREDOSIA HARBOR & FLEETING SERVICE, INC. and
RIVER ROAD MARINE REPAIR, INC.

NO. S-Bk-70-1365
(Consolidated Nos. S-Bk-70-1365 and S-Bk-70-1366)

(APPEAL FROM BANKRUPTCY COURT)

FARMERS & TRADERS STATE BANK OF MEREDOSIA, an Illinois Banking Corporation, in its own right and as subrogee of the interests of SCHUYLER STATE BANK OF RUSHVILLE, an Illinois Banking Corporation,
Lien Claimant/Appellant,

vs.

ROBERT M. MAGILL,
Trustee/Appellee.

ORDER

Petitioners/Lien Claimants, Farmers and Traders State Bank, Meredosia, and the Schuyler State Bank, Rushville, appealed to the District Court the Order of the Bankruptcy Judge entered on March 13, 1974. Thereafter, the issues were brief and orally argued and the pleadings and record examined by the Court.

The record reveals generally that the pertinent facts are as follows:

1. Meredosia Harbor and Fleeting Service, Inc., and River Road Marine Repair, Inc., are corporations fully controlled by John D. Rasco.

2. November 6, 1970: Both of the above corporations filed Chapter XI Petitions.

a. Both corporations moved for and secured an order of consolidation of the two cases.

(1) Notice on November 20, 1970, was given all creditors of the consolidation.

(2) Thereafter, both estates were administered under the case name Meredosia Harbor and Fleeting Service, Inc., No. S-Bk-70-1365.

3. On January 4, 1971, there was an adjudication of bankruptcy.

4. October 1, 1970: Assets of River Road Marine included two vessels, "Anita Marie" and "Mary Ann."

a. Rasco, on behalf of River Road, delivered to Farmers and Traders State Bank of Meredosia and to Schuyler State Bank of Rushville an instrument mortgaging the two vessels.

(1) The mortgages were issued by Rasco to cover large overdrafts, $170,000 to the Schuyler State Bank and $130,000 to the Farmers and Traders State Bank, which arose by virtue of the banks having credited River Road's account for checks that were subsequently dishonored.

b. The vessels were subsequently sold by the Trustee who now holds the proceeds pending the determination of the following issues:

(1) Whether the Bankruptcy Court had jurisdiction to determine the validity of liens perfected under the Ships Mortgage Act of 1920.

(2) Whether the lien of a Preferred Ships Mortgage is subject to a trustee's action, pursuant to Section 60 of the Bankruptcy Act, to set aside or avoid a preference.

(3) Whether 11(e) in any way bars the trustee from proceeding against the Preferred Ship Mortgage liens.

(4) Whether River Road Marine and Meredosia Harbor were improperly consolidated under one case name.

(5) Whether the Trustee proved that the mortgage was a preference and therefore void.

(6) Whether unauthorized use of Grand Jury transcripts occurred at trial.

The above issues are considered individually as follows:

1. Issue

Whether the Bankruptcy Court had jurisdiction to determine the validity of liens perfected under the Ships Mortgage Act of 1920, 46 U.S.C. § 911, et seq.

Appellant banks assert that the validity of a Preferred Ships Mortgage lien perfected in accordance with the Ships Mortgage Act of 1920, 46 U.S.C. § 911, *et seq.* is not subject to the jurisdiction of a bankruptcy court. Appellants assert that only a court of admiralty can question the validity of a Preferred Ships Mortgage Lien. The Trustee, on the other hand, asserts that since the two ships in question were in the possession of the Bankruptcy Court, the Bankruptcy Court has exclusive jurisdiction to determine all controversies relating to the property and liens thereon.

The Referee held that:

> As between courts of coordinate jurisdiction the first one obtaining the custody of the res is entitled to retain it and to determine the validity of all liens thereon and to set aside those liens obtaining within four months of bankruptcy. This court and not the Admiralty Court has the jurisdiction over the barges, and with the barges in its custody, has complete jurisdiction over those parties holding alleged liens in the barges.

Referee Coutrakon was correct for the following reasons:

a. The court of bankruptcy had possession of the boats

since upon the filing of a petition in bankruptcy, all the property of the alleged bankrupt passes into the custody of the court in bankruptcy. *Collier on Bankruptcy,* 14th Ed., Para. 23.04.

b. Generally, where possession is established, the jurisdiction of the Bankruptcy Court is exclusive. *Collier on Bankruptcy,* 14th Ed., Vol. 2, Para. 23.04.

c. Although there was a split of opinion in older cases, recent cases permit the court which has first secured custody of the property to retain possession and determine all the lien claims asserted against the vessel. *Collier on Bankruptcy,* 14th Ed., Vol. 1, Para. 2.10.

d. Jurisdiction of the Bankruptcy Court extends to maritime lien claims. G. Gilmore and C. Black, *The Law of Admiralty,* Second Ed., 1975, p. 809-810.

2. Issue

Whether the lien of a Preferred Ships Mortgage is subject to a Trustee's action, pursuant to Section 60 of the Bankruptcy Act, to set aside or avoid a preference.

Appellants claim that they have complied with the requirements of Section 922 of the Ships Mortgage Act of 1920, 46 U.S.C.A. §922, and thereby have created a Preferred Maritime Lien. They assert that Section 67(b) of the Bankruptcy Act, 11 U.S.C.A. § 107, bars any action by the Trustee pursuant to Section 60(a) and (b), 11 U.S.C.A. § 96.

I believe that the Trustee's power under § 60 to void liens is not barred in this case for the following reasons:

(a) A preferred mortgage under the Ship Mortgage Act can qualify as a voidable preference under § 60:

> A maritime lien must, like any other claim against an insolvent estate, run the gauntlet of the bankruptcy trustee's avoiding powers under Sections 60, 67 and 70

of the Bankruptcy Act. If a maritime lien arises out of a transaction which could have been avoided by the bankrupt's creditors as a fraudulent conveyance, it will be subject to avoidance by the Trustee in bankruptcy proceedings as it would be in admiralty proceedings. *If a ship mortgage is taken under circumstances constituting a voidable preference under § 60, it will be nonetheless a voidable preference for being a preferred mortgage under the Ship Mortgage Act.* G. Gilmore and C. Black, Jr., *The Law of Admiralty,* 2nd Ed., (1975) (Emphasis added.)

(b) A preferred mortgage under 46 U.S.C. § 922 may in fact not be present. Under 46 U.S.C. § 922(a)(3), an affidavit must be filed "to the effect that the mortgage is made in good faith and without any design to hinder, delay, or defraud any existing or future creditor of the mortgagor or any lienor of the mortgaged vessel." Based upon the transcript of the proceedings before the Referee, I would question whether the good faith requirement has in fact been satisfied. (See excerpts on Page 13.)

(c) Section 67(b) of the Bankruptcy Act, 11 U.S.C. 107(b) does not bar Trustee action under § 60.

Section 67 provides that statutory liens may be valid as against the Trustee even though arising within four months prior to the filing of a bankruptcy petition or perfected while the debtor is insolvent. Section 1(29a) of the Bankruptcy Act, 11 U.S.C.A. § 1 (29a) defines statutory lien as:

> . . . a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by statute.

A lien is not a statutory lien if its creation is dependent upon agreement by the parties to give security. *Collier on Bankruptcy,* 14th Ed., Para. 1:29a, p. 130.28; Para. 67.20.

In the present case, a preferred maritime lien is one dependent upon agreement by the parties. Therefore, the liens in this case are not statutory liens. Thus § 67(b) does not bar Trustee action under § 60.

3. Issue

Whether 11(e) in any way bars the Trustee from proceeding against the Preferred Ship Mortgage liens.

Appellants claim that the Trustee failed to file a mandatory complaint to initiate proceedings to set aside their lien under § 60 within the two year statute of limitations under § 11(d).

This position is for the following reasons without merit:

(a) Section 11(e), 11 U.S.C.A. § 29(e), in part provides:

> . . . (a) trustee may, within two years subsequent to the date of adjudication . . . *institute proceedings in behalf of the estate* upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy . . . . (Emphasis added.)

Section 11(e) applies only where the Trustee initiates suit on behalf of the estate. The Trustee did not initiate suit on behalf of the estate in the present case in regard to the ships in question as the Trustee had possession of the ships. On the contrary, the lienholders came into court and asserted their claims against the Trustee. As Judge Coutrakon stated in his holding:

> Section 11(e) comes into play when a Trustee for instance, seeks in a separate action to recover for the estate a preferential transfer of a res not in the jurisdiction of the bankruptcy court; but it does not come into play when he defends money in his hand from

creditors whose claims would be preferential if successful.

(b) The Trustee was not required to file a formal complaint to initiate proceedings.

Where the controversy concerns property in the actual or constructive possession of the Bankruptcy Court, the Court can exercise summary jurisdiction, and can adjudicate all rights and claims relating thereto. *Collier on Bankruptcy,* 14th Ed., Para. 23.04(2). The Trustee was not obligated to file a complaint to initiate proceedings to void appellants' lien claim since the property in question was already within the Bankruptcy Court's jurisdiction. On the contrary, appellants were given notice along with all creditors on November 20, 1970, by the Bankruptcy Court. Appellants came into court in their own behalf in June, 1973, to prove the validity of their claim and to contest the Trustee's final report.

4. Issue

Whether River Road Marine and Meredosia Harbor and Fleeting were improperly consolidated under one case — Meredosia Harbor and Fleeting Service, Inc., No. S-Bk-70-1365.

Appellants' claim that the consolidation was improper as the court did not give prior notice and a hearing to concerned creditors. In addition, appellants claim that River Road Marine was never adjudicated bankrupt.

(a) Appellants' due process claim is without substance.

Meredosia Harbor and Fleeting Service, Inc., and River Road Marine Repair, Inc., filed Chapter XI petitions on November 6, 1970. Each corporation simultaneously filed petitions to consolidate. The court entered a consolidation order on November 6, 1970. On November 20, 1970, all

creditors of the corporations received notice of the consolidation. Judge Coutrakon in his opinion stated that the consolidation was only for expediency and no creditor was denied a right to assert á claim.

I do not believe that prior notice and hearing would be required in this setting since appellants may well have waived any due process right which might exist. No property right of any creditor is jeopardized by the procedure followed. Creditors received prompt notice of the consolidation order; however, there is no indication in the record that this point was raised prior to January, 1974, when appellants submitted a trial brief to the Referee. In fact, in his order, the Referee stated that the estates were administered as one with objection from no one. It is inappropriate for appellants at this point to suggest that prompt subsequent challenge on their part of the consolidation order would not have protected their interests.

(b) Appellants' claim that River Road Marine was never adjudicated bankrupt is without substance.

Both Meredosia Harbor and Fleeting and River Road filed petitions to consolidate. Both petitions state that the corporations have operated jointly and that River Road Marine is a wholly-owned subsidiary of Meredosia Harbor. On November 6th, the Court entered an order of consolidation under the name of Meredosia Harbor and Fleeting, as cause No. S-Bk-70-1365. The following notice of consolidation was given to creditors on November 20, 1970:

> On November 6, 1970, River Road Marine Repair, Inc., filed its petition for an arrangement under Chapter XI of the Bankruptcy Act, case No. S-Bk-70-1366, and on November 6, 1970, an Order was entered that said River Road Marine Repair, Inc., be consolidated with Meredosia Harbor & Fleeting Service, Inc., and that these cases proceed under one case — Meredosia Harbor and Fleeting Service, Inc., No. S-Bk-70-1365.

Where two or more cases are pending in the same court by the same bankrupt, the court has discretion to order consolidation of the cases. Bankruptcy Rule 117(a) [derived from General Order 7]. The Advisory Committee Notes state that consolidation of cases implies unitary administration of the estate.

In this case, the Referee properly exercised his discretion to consolidate. Both the petitions by the bankrupt corporations and the record indicate that the two companies were operated jointly. In addition, the Referee, acting upon the request of the corporations stated in his opinion that consolidation was done in the interest of expediency. In *Stone v. Eacher,* 127 F. 2d 284 (4th Cir. 1942), the Court granted a motion for consolidation of a corporation and its wholly-owned subsidiary. Quoting a treatise by Latty, the Court stated:

> Perhaps the fairest way of dealing with the situation when both the parent and the subsidiary corporation are insolvent is to let all the creditors of each share pro rata in the pooled assets of both. Such procedure would be especially equitable where the claimants are creditors of both the parent and the subsidiary. At 288.

This, in the present case the order of consolidation was an appropriate exercise of the Referee's discretion.

The fact that the bankruptcy proceedings were administered under the name of Meredosia Harbor alone is not important — especially in light of notice given to all creditors as to the consolidation.

5. Issue

Whether the Trustee proved that the mortgage on the barges was a preference and therefore void.

The elements of a preference under § 60(a) consist of the following: a debtor (1) making or suffering a transfer

of his property, (2) to or for the benefit of a creditor, (3) for or on account of an antecedent debt [resulting in a depletion of the estate], (4) while insolvent, and (5) within four months of bankruptcy, (6) the effect of which transfer will be to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(a) The debtor made the requisite transfer of his property.

Appellants claim that since the barges were owned by River Road Marine and because River Road Marine never was adjudicated to be bankrupt, the requisite transfer *by a debtor* of property is not present.

As indicated above, River Road was properly consolidated with Meredosia and the order of bankruptcy applied to both corporations. Therefore, the requisite transfer is in fact present, i.e. by River Road.

(b) To or for the benefit of a creditor.

This element is not contested by appellants.

(c) For or on account of an antecedent debt resulting in depletion of the estate.

A transfer made in return for a consolidation which the transferor receives at the same time or thereafter is not a preference because not made for or on account of an antecedent debt. Thus, where a creditor takes and perfects security from an insolvent debtor he does not receive a voidable preference if consideration was given by the creditor for the security in the form of a loan. *Collier on Bankruptcy,* 14th Ed., Para. 60.19.

The overdrafts by River Road arose between September 10 and September 21, 1970. The secured mortgage was

issued on October 1, 1970. Appellants claim that the bank officers permitted the overdrafts on the strength of the already negotiated and agreed upon but not issued ship mortgages. Thus, appellants argue that an antecedent debt is not present since the creditor-banks obtained consideration in the form of the agreed upon mortgage in exchange for the overdrafts.

My reading of the record indicates that an antecedent debt is in fact present. The record indicates that the banks allowed the overdrafts to arise without prior consideration of obtaining security from Rasco. Only when it became necessary to cover their overdraft posture in the face of a bank examiner's investigation did the bank officers (from both banks) and Rasco consider and approve the ships mortgage. [See Transcript Vol. 1, pgs. 61-62, Rasco testimoney.]; [Vol. 2, pgs. 200-203, Rasco testimony]; [Vol. 5, pgs. 85, 87, Chrisman testimony — director of Farmers and Traders Bank of Meredosia.] Thus, the record indicates that the overdraft constituted an antecedent debt. The issuance of the mortgages was preferential and depleted the estate.

(d) Whether the transfer was made while the debtor was insolvent.

In order for a preference to exist, a transfer of property must be made by the debtor while insolvent. Under § 1(19) a person is deemed to be insolvent whenever:

> . . . the aggregate of his property, exclusive of any property which he may have conveyed transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, transfer or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts.

Appellants claim that the Trustee failed to demonstrate

that the corporations were insolvent as of October 1, 1970 — the date the mortgage was issued.

However, my opinion based upon the following excerpts from the record is that the corporations were bankrupt as of October 1, 1970:

(a) Mr. Rasco testified that at the time the mortgage was granted, the probability of bankruptcy had been discussed. Vol. 1, pg. 56, 59.

(b) Mr. Rasco testified that as of September 1, 1970, he believed that his liabilities were greater than assets. Vol. 2, pg. 35.

(c) Eugene Estes, a CPA, testified that both corporations were insolvent during September. Vol. 3, pgs. 70, 71, 73, 74.

(d) William C. Stephens, President of Schuyler State Bank, decided Rasco was insolvent long before "it broke."

(e) Basil Humphrey, a CPA, testified that with hindsight the companies appeared to have been insolvent on October 1. Vol. 6, p. 50.

(f) Transfer within four months of bankruptcy.

This element is not contested by appellants.

(g) Whether the transfer enabled the creditor bank to obtain a greater percentage of its debt than some other creditor of the same class.

The test for this element under the Act is whether a creditor has obtained out of the bankrupt's property a greater percentage of his debt than some other creditor of the same class. Creditors, who, in the absence of preferences, are entitled to receive the same percentage upon their claims out of the estate of the bankrupt are members

of the same class. *Collier on Bankruptcy,* 14th Ed., Vol. 3, Para. 60.34.

Appellants claim that the record before the court on appeal contains no specific reference to any creditors other than the United States Government which claims a tax lien. Appellants state that the record only refers to all other creditors in the aggregate. Appellants then argue that since their Preferred Ship Mortgage has priority over the Federal Tax Lien, they are not creditors in the same class as the United States Government. In addition, appellants argue that the United States Government is not a creditor within § 60.

However, much of appellants' argument is moot as they do not possess a valid preferred ships mortgage. Every preferred ships mortgage must be supported by an affidavit. The affidavit must recite that the application for preferred mortgage status is made in good faith and without design to hinder, delay or defraud existing or future creditors. In light of the following excerpts from the record, this good faith requirement could not have been met.

(a) Representatives of both banks agreed on the mortgage. Vol. 1, p. 52.

(b) At the time the mortgage was arranged, bankruptcy was contemplated by all parties. Vol. 1, pgs. 56, 59; Vol. 2, p. 205.

(c) Mortgage was agreed upon after the large overdraft developed. (See p. 11.)

(d) Rasco paid off officers of both banks to help get loans approved. Vol. 1, pgs. 72-3, 78-80.

(e) As of September 1, 1970, Rasco admits his liabilities were larger than his assets. Vol. 2, p. 35.

(f) Duesterhaus, an employee of the Bank of Meredosia in the loan department, heard of the check kiting scheme in the latter part of September when the IRS and FBI conducted an investigation. Vol. 3, p. 105.

(g) Duesterhaus notified Thormahlin and Westerphal (President and Vice President of the Bank of Meredosia) as to the overdraft. They replied that Westphal knew what was going on. Vol. 3, p. 101.

(h) Pezman, Chairman of the Board of Schuyler State Bank, first questioned the solvency of Rasco around September 10 or 11th and thereafter "it began to snowball." Vol. 4, pgs. 113-114, 117.

(i) William Stephens, President of Schuyler State Bank, decided Rasco was insolvent long before it broke. Vol. 4, p. 137.

Since the preferred ships mortgage is invalid, the banks are in the same class as other general creditors. The question is whether, as appellants claim, the record on appeal fails to specify additional general creditors.

Appellants admit in their brief that the record mentions "other creditors" in the aggregate. Affidavits written by Rasco listing creditors appear in the record before the court. Therefore, the record before the court sufficiently specifies additional general creditors.

Since the banks are members of a general creditors class, the transfer of the mortgage would have enabled the bank to obtain a greater portion of its debt than creditors in the same class or in a prior class. See *Collier,* Para. 60.34.

(j) Whether the creditor banks had reasonable cause to believe that the debtor was insolvent.

Since the banks are members of a general creditor class, the transfer of the mortgage would have enabled the bank

to obtain a greater portion of its debt than creditors in the same class or in a prior class. See *Collier,* Para. 60.34.

(k) Whether the Creditor banks had reasonable cause to believe that the debtor was insolvent.

Section 60(b) provides that a preference as defined in 60(a) can be avoided by the trustee if the creditor receiving it, at the time the transfer was made, has reasonable cause to believe that the debtor is insolvent. Insolvency is defined in 1(19). Knowledge or actual belief of insolvency is not required; all that is required is a reasonable cause to believe that the debtor was insolvent at the time of the preferential transfer. *Collier,* Para. 60.53.

Based on the excerpts from the record already referred to, I believe the banks had reasonable grounds to believe the debtor was insolvent.

6. Issue.

Whether unauthorized use of grand jury transcripts occurred at trial.

Appellants point to the following exchange found at Vol. 4, pages 124-125, in support of their argument that grand jury minutes were wrongfully used:

> "MR. BEIL: Now, for the record, please, I'd like the record to show that during the course of the cross examination of Judge Pezman, Mr. Pilolla, an Assistant District Attorney for this District, has been examining what appears to be a transcript of His Honor's testimony before the Grand Jury, and has had numerous conferences with the Trustee, who had been conducting the cross examination, and that cross examination was based in whole or in part, or could have been, on the basis of prior testimony.
>
> "But that yesterday, when I requested the same courtesy and consideration, to have the transcript of

> the testimony that Mr. Duesterhaus gave before the Grand Jury so I could use that in cross examination, it was denied.
>
> "And I think — would like for the Court to take judicial notice of that fact and would like the record to so indicate the fact.
>
> "REFEREE COUTRAKON: I can't take judicial notice of it, haven't seen it, Mr. Beil.
>
> "MR. BEIL: Is that true, Mr. Pilolla?
>
> "MR. PILOLLA: Your Honor, I have no idea what his work papers are, and I would think that I would have the prerogative of keeping our working papers to ourselves. There has been no reference to Grand Jury testimony, at all."

This contention appears to be without substance.

Wherefore, the issues are found against appellants and the Referee's Order is affirmed. All other objections raised in the briefs and arguments are deemed to be without merit.

Enter this 23rd day of October, 1975.

/s/ Harlington Wood, Jr.
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS
SOUTHERN DIVISION

IN THE MATTER OF:

MEREDOSIA HARBOR & FLEETING SERVICE, INC., being a consolidated case of:

MEREDOSIA HARBOR & FLEETING SERVICE, INC. and
RIVER ROAD MARINE REPAIR, INC.

FARMERS & TRADERS STATE BANK OF MEREDOSIA, an Illinois Banking Corporation, in its own right and as subrogee of the interests of SCHUYLER STATE BANK OF RUSHVILLE, an Illinois Banking Corporation,
Lien Claimant/Appellant,

vs.

ROBERT M. MAGILL,
Trustee/Appellee.

NO. S-Bk-70-1365
(Consolidated Nos. S-Bk-70-1365 and S-Bk-70-1366)

ORDER

The following coming on for determination, all of which have been heard and considered by this Court:

A. Objections of Farmers and Traders State Bank of Meredosia, filed February 7, 1973, objecting to the final account of the Trustee;

B. Petition by Farmers & Traders State Bank of Meredosia to reclaim property subject to maritime mortgage or the proceeds therefrom Trustee; filed herein March 23, 1973;

C. Trustee's Affirmative Defense to objection to final report of Trustee and Reclamation Petition of Farmers & Traders State Bank of Meredosia, filed herein May 11, 1973;

D. Trustee's Affirmative Defense to objection to final report of Trustee and Reclamation Petition of Farmers

& Traders State Bank of Meredosia, filed herein May 29, 1973;

E. Petition to reclaim property, subject to maritime mortgage, or the proceeds therefrom, from Trustee, filed herein by the Schuyler State Bank on June 19, 1973;

F. Motion to Dismiss Trustee's pleadings and evidence for delivery of property and other relief filed herein November 20, 1973, by the Farmers & Traders State Bank of Meredosia, Meredosia, Illinois, on November 20, 1973.

I.

Findings of Fact

1. The Bankrupt, Meredosia Harbor & Fleeting Services, Inc., and Riverroad Marine Repair, Inc. corporations, each fully controlled by John D. Rasco, filed Chapter 11 Petitions in this Court November 6, 1970. At that time it was moved and order made that the two cases be consolidated.

2. On November 20, 1970, notice was mailed to all creditors of the debtors, calling a first meeting of creditors, and to this notice was appended:

> "On November 6, 1970, Riverroad Marine Repair, Inc. filed its petition for an arrangement under Chapter XI of the Bankruptcy Act, Case No. S-BK-70-1366, and on November 6, 1970, an order was entered that said Riverroad Marine Repair, Inc. be consolidated with Meredosia Harbor & Fleeting Service, Inc., and that these cases proceed under one case — Meredosia Harbor & Fleeting Service, Inc., No. S-BK-70-1365.

3. Thereafter, the two cases were administered as one, with no objection. This was done for expediency. No person was denied a hearing or any right whatsoever to press his claim because of the consolidation.

4. Neither of the corporations received any capital, nor contributions, from inception until date of bankruptcy.

5. On October 1, 1971, both corporations were insolvent and the Farmers & Traders State Bank of Meredosia and the Schuyler State Bank of Rushville were aware of the insolvency of the corporations. Both the Farmers & Traders State Bank of Meredosia and the Schuyler State Bank of Rushville were then aware that they had been victimized by a check-kiting scheme conceived and operated by John Rasco. Rasco conducted the check-kiting operation through the use of accounts in the name of the two corporations, which accounts were located in at least five banks, including the above-named banks. Following the bank examination by examiners at the Farmers & Traders State Bank of Meredosia during September, 1970, a phone call from National Boulevard Bank of Chicago on September 15th to an officer of the Schuyler State Bank of Rushville informing the bank that on that date $120,800.00 checks drawn by Rasco were being returned, and conversations between the officers of the Schuyler and Meredosia banks, both banks were then aware of the apparent insolvency of the two bankrupt corporations. As a result both banks determined the amount of their respective losses resulting from the check-kiting scheme.

6. The bankrupt corporations were in fact insolvent on October 1, 1970, and no new capital was acquired by the corporations. From that point the assets of the bankrupt corporations depreciated rather than appreciated. On October 1, 1970, the Farmers & Traders State Bank of Meredosia demanded and received a note secured by the mortgage on the boats to attempt to secure its loss of $170,000.00 from the check-kiting scheme. Likewise, the Schuyler State Bank on the same date demanded and received a note in the amount of $130,000.00 secured by

the same mortgage on the boats to attempt to secure its loss in the check-kiting scheme.

7. The total assets of both bankrupt companies as of October 1, 1970, had a fair cash market value of less than $70,000.00.

8. The total claims in both estates, exclusive of the subrogated claims of the insurance companies paid to the banks in connection with their losses, amount to $401,356.64. Each of the bankrupt corporations had debts far in excess of $70,000.00 on October 1, 1970. All debts on which claims were filed were received on or before October 1, 1970.

9. On the date of adjudication of the companies in bankruptcy, the Trustee of the estate had and retained full possession of the two boats subject of the mortgages, namely the ANITA MARIE and the MARY ANN, both of which were located at Meredosia, Illinois. These boats were then and remained in the custody of this Bankruptcy Court.

10. The ANITA MARIE was then in the water and approximately 95% complete. The MARY ANN was not in the water and was a partially completed hull with shafts, but engines, screws, rudder, steering mechanism, and living quarters were not installed. Both boats were incomplete when the mortgage was executed. Since the boats were not completed at the time the mortgage was executed and filed the documentation was fraudulent and the ships mortgage void.

11. The Trustee filed his petition to sell the two boats free and clear of all liens on January 14, 1971, and all creditors, both general and secured, were given new notice of the Trustee's petition for leave to sell.

12. A show cause order as to why the boats should not be sold free and clear of all liens was entered and legal

notice of the hearing was sent to each of the creditors, both general and secured, on January 15, 1971. Each of the creditors was ordered to show cause if any they had why the property could not be sold on or before January 25, 1971. Neither bank made objection to the sale. Order was entered ordering the vessels sold on June 23, 1971. Both banks consented to the sale, free and clear of liens, with the understanding that any liens against the vessels would be vacated at the time of their sale and that such liens as found out would attach with equal force to the proceeds of sale.

13. On January 2, 1973, the Trustee filed final account. On January 26, 1973, the Bankruptcy Court entered order for final meeting of creditors and all creditors were notified of the final meeting. On February 7, 1973, the Farmers & Traders State Bank of Meredosia filed objection to final report of Trustee.

14. On March 23, 1973, the Farmers & Traders State Bank of Meredosia filed a petition to reclaim the property subject to the maritime mortgage which had been previously sold by the Trustee. This was the first reclamation petition filed with respect to the two boats.

15. On May 11, 1973, the Trustee filed an affirmative defense to objection to final report of Trustee of reclamation petition of Farmers & Traders State Bank of Meredosia.

16. May 29, 1973, the Farmers & Traders State Bank of Meredosia filed reply to Trustee's May 11, 1973 affirmative defense.

17. On June 19, 1973, Schuyler State Bank of Rushville filed reclamation petition to reclaim the two boats or proceeds.

18. Thereafter, hearings were held and all parties presented their evidence.

PART II

CONCLUSIONS OF LAW

1. "Where possession (of the assets in question) is established to the satisfaction of the court (in bankruptcy), its jurisdiction is exclusive and it may proceed to determine controversies with respect to the property and the extent and character of liens thereon or rights therein." *Collier on Bankruptcy,* 14th Ed., Vol. 2, pg. 459.

2. As between courts of coordinate jurisdiction the first one obtaining custody of the res is entitled to retain it and to determine validity of all liens thereon and to set aside those liens obtained within four months of bankruptcy. This court and not the Admiralty Court has the jurisdiction over the barges in its custody, has complete jurisdiction over those parties holding alleged liens on the barges. Whether the creditor has filed a secured claim is wholly immaterial. An alleged lienholder must respond to show cause order or default. If he appears, the burden is upon him to prove his lien. In Re Ripp (CA — 7th; 1957) 242 F. 2d 849. *Collier on Bankruptcy,* 14th Ed., Vol. 2, pg. 459.

3. "Once the court acquires possession, the jurisdiction to determine all conflicting claims will remain, and there can be no interference with such possession upon the part of any other court except by way of review or appeal." *Collier on Bankruptcy,* 14th Ed., Vol. 2, pg. 461.

4. "Once consent to the summary jurisdiction of the bankruptcy court appears, that jurisdiction generally will be retained for the determination of all the claims of the parties and for the enforcement of all their rights against each other. Consent having been given it may not subsequently be withdrawn by a party, nor may the party, upon

appeal from the decision, raise the question of what of jurisdiction. Consent as hereafter demonstrated may be (1) express; (2) by waiver through failure to raise proper objection or (3) implied from any act indicating a willingness on the part of the party that his claim or interest be determined summarily by the bankruptcy court." See *Collier,* 14th Ed., Vol. 2, pgs. 533, 534.

5. "It should be remembered that as to property in its actual or constructive possession, or the proceeds thereof, the bankruptcy court has the exclusive (and summary) jurisdiction to determine the validity, amount and priority of all liens and encumbrances thereon. Thus, when the proceeds of the sale are before the court for distribution the lienors or encumbrancers will be entitled to such funds in the manner, amount and priority fixed by the bankruptcy court." See *Collier,* 14th Ed., Vol. 4, pgs. 1219, 1220.

6. "A claimant who consented to a sale by the trustee is bound by his consent and must assert his rights against the proceeds." *Collier Bros. v. Wiseman,* (CA 6th, 1957) 242 F. 2d 511, Matter of Electric Specialty Co., 36 Am. B.R. (N.S.) 131.

7. "Sec. 60a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class." See *Collier on Bankruptcy,* 14th Ed., Vol. 3, pg. 731. 60(b) "Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference

thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent." See *Collier,* 14th Ed., Vol. 3, pg. 734.

8. "The repayment to a bank of money obtained by depositing a worthless check and drawing checks against the credit so obtained is a preference voidable by a trustee in bankruptcy." *Abraham Kainberg, Trustee v. Springfield National Bank,* Appt. 103 A.L.R. 306.

9. "Delayed remittances, increase of loans, and overdrafts are so suggestive of financial embarrassment that a creditor receiving a transfer cannot ignore them." 9 Am. Jur. 2nd, pg. 808.

10. "A history of overdrafts and unpaid notes, in addition to the type of financial statements submitted and the nature of the financing of the bankrupt, were sufficient to call for inquiry by the bank which would have disclosed insolvency on the date of the preferential assignment to the bank." *Re Shelley Furniture, Inc.,* (CA7 Ill.) 283 F. 2d 540.

11. Title 46 Sec. 922 of the U.S. Code provides that a condition precedent to a preferred mortgage is

> "(3) An affidavit is filed with the record of such mortgage to the effect that the mortgage is made in good faith and without any design to hinder, delay, or defraud any existing or future creditor of the mortgagor or any lienor of the mortgaged vessel."

PART III

OPINION

Meredosia Harbor & Fleeting Service, Inc. and River Road Marine Repair, Inc., corporations, it appears formed to build river barges each fully controlled by John D. Rasco, filed Chapter XI petitions in this court on November

6, 1970. At the same time it moved for and secured an order of consolidation of the two cases. The banks now object to the conslidation which, they claim, was accomplished without notice to creditors.

On November 20, 1970, a notice was mailed to all creditors of the debtors, calling a first meeting of creditors and to this notice was appended:

> On November 6, 1970, River Road Marine Repair, Inc. filed its petition for an arrangement under Chapter XI of the Bankruptcy Act, case No. S-Bk-70-1366, and on November 6, 1970, an Order was entered that said River Road Marine Repair, Inc. be consolidated with Meredosia Harbor & Fleeting Service, Inc. and that these cases proceed under one case — Meredosia Harbor & Fleeting Service, Inc., No. S-Bk-70-1365.

Thereafter the two estates were administered as one, with objection from no one. This was done only for expediency. No person was denied a hearing or a right to press his claim herein because of the consolidation. In fact, the banks are now being given their right to a hearing.

Within four months of the filing of the petitions in this court John D. Rasco, the corporate president, in behalf of River Road, delivered to Farmers and Traders Bank of Meredosia and Schuyler State Bank of Rushville an instrument purporting to mortgage two barges in the possession of the bankrupt. This mortgage was given, so the banks claim, to secure loans advanced to River Road between September 10 and September 21, 1970, which loans arose by virtue of the banks having credited River Road's account for checks that subsequently were dishonored. That the correct terminology for this advancement of credit on uncollected funds deposited in the banks was anything but a simple case of "check kiting" goes with little further comment. Their losses totalled $300,000. At the Trustee's

sales, the barges brought some $45,000. At the time the mortgage was executed the banks were aware of their losses. They loaned no new money. The mortgage was therefore given for an antecedent debt. The barges were incomplete, one in the water but only 95% completed, the other still in state of construction.

That the bankrupts were hopelessly insolvent at the time of the mortgage transaction is settled. John D. Rasco, the owner, had never contributed one dime of capital and there was no showing that any services he rendered in behalf of the corporations ever proved tc be of any monetary value.

The trustee petitioned to sell the personal property herein, including the barges, and by order of this court, the Schuyler State Bank, among others, was ruled to show cause why the property should not be sold free of its lien, with its lien, if found valid, to attach to the proceeds thereof. The Meredosia Bank was not so ordered but appeared anyway at the hearing on the petition to sell to say it had no objection to the sale of the barges, "in that the said funds (therefrom) would not be expended until the determination of whether or not the mortgage" /sic/ of the banks "were valid liens on said motor vessels." Any inadequacy of notice here is waived by the Bank's voluntary appearance and submission to the Bankruptcy Court. The Schuyler Bank, by its silence, consented to the sale too, and nothing further was done with respect to the mortgage until the Trustee filed his final report, at which time the Banks took exception to the report and made claim to the funds in the Trustee's hands because of their mortgage.

To the exceptions the Trustee replied that the mortgage on the barges was a preference and therefore void. Thereafter an extensive hearing was held and briefs were filed as

to the rights to the money, in other words, the validity of the mortgage.

As between courts of coordinate jurisdiction the first one obtaining custody of the res is entitled to retain it and to determine validity of all liens thereon and to set aside those liens obtained within four months of bankruptcy. This court and not the Admiralty Court has the jurisdiction over the barges, and with the barges in its custody, has complete jurisdiction over those parties holding alleged liens on the barges. Whether the creditor has filed a secured claim is wholly immaterial. An alleged lienholder must respond to a show cause order or default. If he appears, the burden is upon him to prove his lien.

The Meredosia Bank and the Schuyler State Bank, both being in court, there is no application of two-year limitation of Section 11e of the Bankruptcy Act. It was not up to the Trustee to inquire, other than he did, by what right any alleged lienholders might claim money in his hands, but the lienholders' duty to come into court to prove up their secured claims. This they did, and I find that all requisites of a preference being present, the claims of the banks filed under the title of Reclamation Petitions are denied. Section 11e comes into play when a Trustee, for instance, seeks in a separate action to recover for the estate a preferential transfer of a res not in the jurisdiction of the bankruptcy court; but it does not come into play when he defends money in his hands from creditors whose claims would be preferential if successful.

Every preferred ship's mortgage (Title 46 U.S.C. 922) requires it be supported by an affidavit to be filed with it. The affidavit must recite that it is made in good faith and without design to hinder, delay or defraud existing or future creditors. Neither the grantor nor the grantees of

the mortgage could have made such an affidavit, for at the time of the execution of the mortgage all knew or should have known such a statement was in fact false.

While the Trustee did not press the validity of the mortgage in its execution, I should like to make my own comments thereon. The evidence supporting the execution is sketchy. There is no provision in the law that allows documenting as a U.S. vessel an uncompleted boat. Documenting presupposes a completed boat. For the purpose of trying desperately to save something for themselves, the banks hurriedly concocted a preferred ship's mortgage after causing a fraudulent documenting of the vessels. On this score, I find the mortgage void.

The $170,000 claim of the Farmers and Traders State Bank of Meredosia is allowed as a general claim.

The $130,000 claim of Schuyler State Bank is allowed as a general claim.

The objections of the two Banks to the final account of the Trustee are denied.

The Reclamation Petitions of the Banks are denied.

The Motion to Dismiss and for other relief filed herein November 20, 1973 by the Meredosia Bank is denied.

Entered: May 1, 1974.

/s/ Basil H. Coutrakon
Bankruptcy Judge